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CORPORATE PARTICIPANTS

Brian E. Cabrera *Quantum Corporation - Senior VP, Chief Legal & Compliance Officer and Secretary*

James J. Lerner *Quantum Corporation - Chairman, President & CEO*

James Michael Dodson *Quantum Corporation - CFO*

CONFERENCE CALL PARTICIPANTS

Craig Andrew Ellis *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

Eric Martinuzzi *Lake Street Capital Markets, LLC, Research Division - Head of Research & Senior Research Analyst*

George Michael Iwanyc *Oppenheimer & Co. Inc., Research Division - Associate*

Nehal Sushil Chokshi *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

PRESENTATION

Operator

Good afternoon, everyone, and thank you for participating in today's conference call to discuss Quantum's Financial Results for the Third Quarter of Fiscal 2022. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Brian Cabrera from Quantum.

Brian E. Cabrera - *Quantum Corporation - Senior VP, Chief Legal & Compliance Officer and Secretary*

Good afternoon, and thank you for joining today's conference call to discuss Quantum's Third Quarter Fiscal 2022 Financial Results I'm Brian Cabrera, Quantum's Chief Legal and Compliance Officer. Joining me today are Jamie Lerner, Chairman and CEO; and Mike Dodson, CFO.

This afternoon, we issued a press release, which you can access a copy of on Quantum's website at www.quantum.com under the Investor Relations section. There is also a slide presentation that we will be using in conjunction with today's call that may be accessed through the webcast link on the IR website and is also posted as a PDF in the Investor Relations section.

As a reminder, comments made during today's conference call may include forward-looking statements. All statements other than statements of historical fact could be deemed as forward looking. Quantum advises caution and reliance on forward-looking statements. These statements include, without limitation, any projections of revenue, margins, expenses, Adjusted EBITDA, Adjusted Net Income, cash flows or other financial items; also any statements concerning the expected development, performance and market share or competitive performance relating to products or services. All forward-looking statements are based on information available to Quantum on the date hereof. These statements involve known and unknown risks, uncertainties and other factors that may cause Quantum's actual results to differ materially from those implied by the forward-looking statements, including unexpected changes in the company's business. More detailed information about these risk factors and additional risk factors are set forth in Quantum's periodic filings with the Securities and Exchange Commission. These risk factors include, but are not limited to, risks and uncertainties listed in the section entitled "Risk Factors" in Quantum's Quarterly Report on Form 10-Q and Annual Report on Form 10-K as filed with the SEC. Quantum expressly disclaims any obligation to update or alter its forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law.

Additionally, the company's press release and management statements during the conference call will include discussions of certain measures and financial information in GAAP and non-GAAP. Included in the company's press release are definitions and reconciliations of GAAP to non-GAAP items, which provide additional details.

For those of you unable to listen to the entire call at this time, a recording will be available for at least 90 days in the Investor Relations section of Quantum's website.

Now I would like to turn the call over to the Chairman and CEO, Jamie Lerner. Jamie?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Thank you, Brian, and thank you all for joining us today.

Earlier this afternoon, we announced results for our third fiscal quarter. Revenue was $95.3 million with backlog increasing sequentially to $62 million, another quarterly record for the company, with strong demand offset by ongoing supply chain headwinds. Our recurring revenue transition continued to accelerate with more than 255 customers utilizing Quantum's subscription solutions, up 30% sequentially and 98% year-over-year. With more products transitioning to a subscription contract, our year-over-year subscription revenues increased more than 190%.

Our flat third quarter revenue results are not indicative of the true underlying demand trends in our business, which have been at historically high levels, but impacted by the unprecedented supply chain headwinds. The third fiscal quarter represents our fifth sequential quarter of bookings exceeding revenue. As Mike will discuss, we estimate that roughly $26 million of customer orders in the quarter could not be fulfilled, which had a major impact on revenue, gross margins, earnings and adjusted EBITDA. I'll discuss the supply chain situation and the actions we are taking in more detail shortly.

Our hyperscale business grew meaningfully both sequentially and year-over-year despite the supply challenges and has become less lumpy over the last 4 quarters. Our media and entertainment vertical has begun to stabilize, while not above pre-COVID levels. Our progress within StorNext, the first point product we transitioned to a subscription model has begun to take hold. Revenues for StorNext in the third fiscal quarter were flat year-over-year, but the prior year was primarily a product sale, while this quarter, we are deferring a portion of the initial upfront revenue due to our shift towards subscriptions.

The chart on the left provides a picture of how significant the increase in backlog has been over the last 5 quarters, while revenue has remained essentially flat. The disconnect between our reported quarterly revenue and acceleration in levels of backlog is due to the unprecedented headwinds we have faced within our supply chain.

Also during the quarter, we had multiple shipping partners decide not to accept deliveries on New Year's Eve, a change from years past, which further limited our ability to ship and recognize revenue. We also saw significant cost increases for raw materials needed to fulfill customer orders, coupled with much higher levels of freight and shipping costs that were materially higher than we previously anticipated.

Now let me turn to a more detailed discussion of the supply situation, which remains very dynamic with new challenges being introduced that weren't present even a few months ago. While supply of tape drives has improved for LTO-7 and LTO-8, the biggest impact to our business remains the quantity of supply, which has not yet returned to normalized levels.

During the third quarter, LTO-9 tape drives started shipping, but overall supply of LTO-9 drive has been constrained due to initial manufacturing challenges, which is typical during a transition to a new version of LTO technology. This was especially notable with one of our largest hyperscale customers who converted a large order for LTO-8 drives to LTO-9 drives during the quarter and increased their order by $10 million. Due to limited availability of LTO-9 drives, this switch impacted our ability to fulfill the order, and our reported revenue, as our prior guidance, included shipments for LTO-8-based drives to this customer.

In addition to the headwinds we are facing in supply of tape drives, we are experiencing broad-based shortages of components for servers, network cards and circuit boards, very consistent with what peers in the storage industry are citing. We continue to work closely with our suppliers, as well as our contract manufacturers to mitigate current supply shortages, which as of today, we lack the visibility to state when a more normalized supply chain will return.

Under these circumstances, we are immediately implementing a series of cost reduction measures. We are instituting pricing increases across our product categories, and we are focusing on supply chain and operational excellence.

Some other highlights from the quarter include continued share gains in the hyperscale tape market. As of today, 4 of our hyperscale customers now utilize more than an Exabyte of storage capacity, and we continue to view this business as a growth driver in future years.

During the third fiscal quarter, we closed a multimillion-dollar video surveillance deal at a government agency, which is currently in backlog. This deal highlights our recent success at the cross-selling and up-selling occurring between Pivot3 and Quantum-based solutions. Another example of our product cross-selling success we've had to date, we sold StorNext as the subscription combined with tape to create an effective customer-friendly solution for long-term retention of surveillance data. This was a conversion win, utilized by a large distributor in Southern California previously using a competitive solution. The newly deployed solution now captures surveillance data on Quantum software and uses Quantum tape for long-term retention and archiving. We believe this type of win is very repeatable and only Quantum offers this 'end-to-end' portfolio.

Also, during the quarter, we closed a multimillion dollar object storage deal with a genomics research institution and closed our first 6-figure software-only object storage win at a large semiconductor manufacturer with a third party providing the hardware component. Both customers are managing large unstructured data sets, and Quantum's solution offers unique value in terms of scale, durability and ease of use. It was also a solid quarter for the H-Series and F-Series within primary storage, mostly within the media and entertainment vertical. We continue to get recognized for our innovation during the quarter as our Ransom Block solution garnered 2 industry awards, and our solutions for ransomware protection and cyber-resilience continue to resonate and gain traction in the market.

Now I'd like to turn the call over to Mike to provide more detail on the results, then we can take questions. Mike?

James Michael Dodson - *Quantum Corporation - CFO*

Thank you, Jamie. Welcome, everyone, to our call today.

Our third fiscal quarter of 2022 represented another quarter of strong customer demand, albeit with continued significant supply chain headwinds as Jamie summarized earlier on this call. Revenue for the quarter was $95.3 million, up 2% sequentially. Adding to the ongoing supply chain constraints during the quarter was rising cost pressures that impacted our gross margins to a greater extent than expected.

As a result of the continued strong customer demand, coupled with the supply chain constraints, the customer order backlog grew over $10 million during the quarter to $62 million from $50 million last quarter and $30 million as of June 30, 2021. Approximately $26 million of orders in the ending backlog could have been shipped to customers in the third fiscal quarter if we would have had the support from the supply chain. This $26 million in unfulfilled orders compares to just over $15 million in unfulfilled orders in the prior quarter. Just over $50 million of the ending backlog represented tape products for which the majority was for orders from our hyperscale customers.

As of today, we anticipate that the supply chain constraints will remain challenging, limiting the company's ability to ship against all customer demand and recognize a meaningful portion of the current backlog.

During the third fiscal quarter, secondary storage revenues were up 17% sequentially, primarily driven by the increase in hyperscaler revenues as well as the improving supply of LTO-7 and LTO-8 drives that help support sequential revenue growth.

Primary storage systems saw a sequential decline in revenue, down 17%, partially due to a delay in the recovery within our Federal vertical combined with deferring a portion of revenue as we grow our subscription business with revenues from StorNext.

The increase in devices and media during the third quarter, up 20% sequentially, benefited from improved supply of certain tape drives following multiple quarters of headwinds.

GAAP and non-GAAP gross margin in the third fiscal quarter was 37%, down over 4 percentage points from the prior quarter. During our call last quarter, we noted our expectations were for cost pressure, which at the time, we anticipated could impact our gross margin by as much as 2 percentage points. However, during the third fiscal quarter, we experienced much higher manufacturing costs, combined with higher freight, warehouse and other logistics costs that, in total, had a more severe impact than expected on our gross margin in the quarter.

Given the increasing costs in virtually all aspects of our supply chain, we are implementing another price increase this quarter. As we mentioned on the call last quarter, we implemented a 5% price increase for our products, but now feel a more substantial additional increase is required to offset the rising cost environment. We expect the benefit from these price increases to take 1 to 2 quarters to gain full traction.

GAAP operating expenses in the third quarter were $42.4 million compared to $39.3 million in the prior quarter. Non-GAAP operating expenses in the third fiscal quarter were $36.4 million, an increase of approximately $1 million sequentially. The increase was primarily due to inclusion of expenses related to a full quarter of Pivot3 and EnCloudEn, increased sales and marketing spend, and increased investment for the development of next-generation LTO technology. These increases were partially offset by a non-recurring benefit from reduced ERP support costs related to legacy installation that is being replaced.

Given the continued pressure on revenues due to the supply chain constraints, combined with the increasing supply chain cost environment, in addition to increasing our prices, we are also implementing certain operating expense reduction programs in the fourth fiscal quarter. We expect to reduce our operating expense run rate between $1 million and $2 million during the fourth fiscal quarter.

GAAP net loss in the third fiscal quarter was $11.1 million or a loss of $0.19 per share. This compares to a net loss of $9.3 million or a loss of $0.16 per share in the prior fiscal quarter, which included a debt extinguishment charge of $15 million, partially offset by a gain of $10 million for the forgiveness of the PPP loan.

Excluding stock compensation, restructuring charges and nonrecurring charges, non-GAAP adjusted net loss in the third fiscal quarter was $4.6 million or a per diluted share loss of $0.07 compared to adjusted net income of $114,000 or breakeven in the prior quarter.

Adjusted EBITDA in the third fiscal quarter was $0.8 million, reflecting lower-than-expected revenues and gross margins due to the unprecedented headwinds we have faced related to the supply chain constraints and related increased costs.

There is a full reconciliation of our non-GAAP results to the most directly comparable GAAP measure in both the press release and the Form 10-Q released today.

Now turning to the balance sheet, liquidity and cash flows. Cash and cash equivalents and restricted cash were $4.3 million as of December 31, 2021, compared to $23.2 million on September 30, 2021.

Adjusted working capital, excluding cash and deferred revenue balances increased by $6.5 million during the third fiscal quarter to $62.3 million from $55.8 million at the end of the prior fiscal quarter. This increase was primarily the result of an increase in accounts receivable, inventories, and other current assets, partially offset by an increase in accounts payable.

Outstanding debt as of December 31, 2021, was $101.7 million after netting $4.6 million in unamortized debt issuance costs compared to $104.5 million of outstanding debt as of September 30, 2021, after netting $4.9 million in unamortized debt issuance costs.

To summarize the $18.9 million decrease of cash of net cash used during the quarter, over half of the net use of cash was the net increase in working capital and net paydown of debt, with the remaining use primarily related to the EnCloudEn acquisition of $2.8 million, net cash used by operating activities of $2 million, excluding changes in assets and liabilities and $1.6 million of CapEx for the quarter.

As of the end of the third fiscal quarter, we remained in compliance with all debt covenants. But, given our current expectations that the supply chain disruptions we have experienced in the last 4 quarters will continue in the foreseeable future, we have begun to work with our lenders to address any potential future covenant compliance issues, as well as any potential need for additional liquidity. We believe this is simply the prudent course to take at this time -- to get in front of any potential issues as we attempt to work through and address headwinds from the supply chain.

Finally, turning to our financial outlook. We do expect continued pressure on revenues due to supply chain constraints, combined with the increasing supply chain cost environment. To a lesser extent, we also have lower seasonal demand in the fourth fiscal quarter. Taking these factors into consideration, for the fourth fiscal quarter of 2022, we are guiding Revenues of $92 million, plus or minus $5 million; non-GAAP adjusted net loss of $4 million, plus or minus $1 million; non-GAAP adjusted net loss per share of $0.07, plus or minus $0.02 and Adjusted EBITDA of breakeven plus or minus $1 million.

With that, I'll turn the call back to Jamie for closing comments. Jamie?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Thanks, Mike.

We believe the underlying demand trends in our business, strong order flow and record levels of backlog reflect the positive momentum of our business transformation. Bookings outgrew revenue for the fifth consecutive quarter, and we continue to drive growth across our hyperscale business, demonstrating the value we're delivering for these leading-edge customers.

We are also closing a higher number of deals, both in number and dollar value across a larger customer base. And we are continuing to convert more customers to a software subscription-based model. Our business is being limited by this unprecedented supply chain environment, and we are working diligently with our suppliers to manage the situation as effectively as possible.

The Quantum team remains committed to delivering continued order momentum, and we are well prepared to exit these constraints at a much higher velocity than just a few quarters ago.

With that, we will now take any questions you may have. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Craig Ellis of B. Riley.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

I wanted to make sure I understood the variance on revenues to start. So I think I heard that there was a $10 million LTO-8 to LTO-9 customer order change issue that impacted sales. Are you saying that, that was the reason that revenues were so materially below the guidance midpoint or is that plus other issues? Can you Mike, just give us a buildup of what the specifics were between, where the guidance midpoint was and where revenue shook up?

James Michael Dodson - *Quantum Corporation - CFO*

Sure, when you look at the guidance of $104 million going to $95 million, really it was supply chain issues, which we knew going in. But really what was different within the quarter was the transition from LTO-8 to LTO-9 was one big issue, where we had forecasted more LTO-8 revenue, but we had customers that were changing their orders from LTO-8 to LTO-9, and we were constrained in LTO-9.

So that was one significant difference or issue that drove the decline. And the other really is a more broad-based shortage of components, servers, network cards, circuit boards to a greater extent than we had experienced in the prior quarter. And really that was the other significant contributor to the revenue shortfall from the midpoint.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

As a follow-up to that and before my second question then, can you just comment on how confident you are in the businesses' ability to forecast demand levels and forecast component needs and really align forecast to customer desires. They're absolutely component constraints out there, and everybody is facing them, but it seems to be impacting Quantum, particularly abruptly in the most recent quarter?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes, Craig, I'll speak to that. We've had to take a significant departure from the way we were forecasting previously. And the departures are on several levels. The first is very often, we would forecast demand, and we would forecast parts that we hoped or expected to arrive. Today, we're forecasting off of deals that we've already closed. We're forecasting off of inventory we already have, parts that are either here or on their way here.

We've just had so many de-commitments or delivery schedules that our suppliers did not meet or pricing levels that they did not meet. So we are now forecasting the 92 off of either -- orders we already have and parts that are already in inventory. So a much higher percentage of that forecast is based on things that we already know versus things we expect. The second thing we're doing, which is a large departure is we're redesigning our products and the componentry within them.

Now many vendors are having supply chain issues, whether it's Cisco or Ford Motor Company or companies of that size. Now we do not have the purchasing power that those companies have. So what we're doing is we're designing our products to use more popular components that have more supply available and are available at lower prices. So rather than try and get supply chain attention versus Ford and Cisco and others, we're modifying our products so that they use components that are easier to get. That's the second thing that we're doing.

And I think between the more conservative forecasting method and the way that we're making our products easier to get components for, we hope to get a better result. But overall, we're choosing a more conservative model -- even a more conservative departure from what we were doing previously.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

And then the second question, Mike, I want to couple to speak items on the income statement. So gross margins, you were clear that you've got cost pressures, a range of them that have caused gross margin to be down 400 basis points in the quarter. The question is this, when do you expect a material improvement in gross margins? And when would you expect that we could see adjusted EBITDA move materially back into the Black.?

James Michael Dodson - *Quantum Corporation - CFO*

Right, so first on the gross margin as we had talked about last quarter, we have increased our prices across all of our products, 5%. And with the further increases we saw this quarter, we are rolling out another set of additional increases, which are going to be higher than that. And I would say, plus or minus, probably at least 10 points additional.

And the issue is the timing because we've got outstanding quotes, you've got outstanding POs. And when do you get traction on that -- the quotes, if they're not accepted, we can requote and requote with the higher prices. We do have, in some of our larger contracts, the ability to go back and renegotiate the price when we have significant price increases, cost increases. So we have that available to us right away and we'll take advantage of that.

So there's a little bit of traction right away. But I would tell you, it's like in my prepared remarks, it's one to 2 quarters before we really see full traction of that just because of all the outstanding quotes that are out there already in the business that's in motion before we can actually get the prices out there and get the benefit.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

So are you saying that -- go ahead?

James Michael Dodson - *Quantum Corporation - CFO*

And then, the second part of your question was EBITDA.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

Yes.

James Michael Dodson - *Quantum Corporation - CFO*

Really when we look at the EBITDA roll forward, we were expecting $5 million this quarter, right. And being lower revenue, we lost $3.3 million of EBITDA and then being a lower rate from 39%, which is 2 points off already to 37%. It's another 1.9%. So we lost 5.2% based on the results of the quarter, and we had 0.8 actually recorded. So we came in at $6 million if we -- it would have been at that level.

So really, it is, first, get through the supply chain constraint period. And when that is, it's difficult to forecast, right. But in the meantime, we are changing our prices, so we address the gross margin at that level regardless of the revenue level. And we are putting into place cost reduction measures that will be in Q4, $1 million to $2 million. So those are the activities that we believe will help address the EBITDA shortfall.

Operator

Our next question is from Nehal Chokshi of Northland Capital Markets.

Nehal Sushil Chokshi - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

So given the supply chain limitations, it feels almost useless to talk about revenue. The much more important thing here is bookings, and thank you for being transparent about the bookings for the December quarter, but what do you expect for the March quarter as far as bookings go?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Nehal, it's Jamie. We expect another quarter where bookings will be ahead of revenue. We do not expect a major reduction in the backlog, which also speaks to bookings strength. We had set a goal for growing our hyperscaler business, 15% to 20% per year, and we thought that was a pretty aggressive goal. We're above doubling that at this point. So we are doing better in our hyperscaler business than we expected.

We had set a goal of having a minimum of $8 million in ARR exiting this year in March 31, and we'll be at or above that goal. We set a goal of $160 million in recurring revenue, and we are going to be above that goal exiting this year. So we're feeling continued bookings strength, and it's a strange way to feel right now and that we're having some of the best sales results that this company has seen in many, many years, both the size of the results across video surveillance, object storage, hyperscaler, enterprise.

We're just having very good traction with our orders, but we are having a hell of a time fulfilling those orders. And right now, we're going to continue driving bookings. We're going to continue driving backlog. We're going to continue driving our subscription customers, which is going really well. So the transition is happening well. Sales results, our new products are resonating, that the Ransom Block just one coolest storage product of the year. We feel really good about that side of the business. But clearly, we've got to cut costs. We've got to get control of pricing. We've got to get control of the supply of materials and make sure we can just get to the other side. Now when we get to the other side of this period, there's no doubt that we are dealing with a larger revenue generating company -- than when we went into this period.

Just the booking strength is you can just see it in a matter if you take the $95 million, we did and you add to it the $26 million we couldn't ship or if you look at it and take the $95 million and add what we grew in backlog. No matter how you construct the quarter you can determine that we are selling well above historic levels. And that part, I feel good about. The part I'm deeply worried about is we've got to get greater control of our materials. We've got to get greater control of their pricing. And until we do that, we've got to control costs internally to steer to that better supply environment.

Nehal Sushil Chokshi - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Right understood. By the way, what is the EBITDA covenant that you guys are going to proactively work towards making sure there's no issue with?

James Michael Dodson - *Quantum Corporation - CFO*

I'm sorry, I'm not sure we got your question.

Nehal Sushil Chokshi - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

So I believe there's a debt covenant -- usually, there's some debt covenants on EBITDA, what is that actual debt covenant on the EBITDA?

James Michael Dodson - *Quantum Corporation - CFO*

The covenants, we don't have an EBITDA covenant strict EBITDA covenant. We've got leverage covenants, fixed charges ratio covenant. We were okay at the end of the quarter. We'll work with our lenders and to the extent that we need any kind of a waiver or need to work with them. We're highly confident that we'll be able to negotiate and work with some lenders on that.

Nehal Sushil Chokshi - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Understood. Do you happen to know what are those levers and fixed charge ratios that must be met?

James Michael Dodson - *Quantum Corporation - CFO*

Yes, I mean it's roughly 3 times. I don't have it right in front of me, right. But we met them at the end of the quarter, and we'll work closely with the bank to see how our forecasts look and stay ahead of it.

Nehal Sushil Chokshi - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Okay. And then, yes, it's great to see continued traction with the subscription customers. I think you said in the press release, it was subscription customers were up 30% Q-o-Q. Your deferred revenue, though, was up only $0.4 million Q-o-Q and a de minimis amount in terms of percentage. How does that reconcile between the big increase in subscription customers on Q-o-Q basis, but we're not seeing that in the 4Q in terms of deferred revenue?

James Michael Dodson - *Quantum Corporation - CFO*

Yes, there's a certain seasonality in the contracts and signing up the contracts. So in the December quarter, it's a little bit slower, and you'll see that peak in the March quarter since everyone kind of coming over the calendar year and then signing up their new contracts. So it's just a bit of a seasonality because it's based on cash, right, cash receipts.

Operator

Our next question is from George Iwanyc of Oppenheimer.

George Michael Iwanyc - *Oppenheimer & Co. Inc., Research Division - Associate*

Jamie, maybe you can dig into the primary storage trends a little bit deeper. Can you give us a sense of how much the pressure you're seeing there is from supply chain? How much was the federal vertical dynamics as well as what you're seeing with that subscription transition?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes, as I mentioned in my comments, the media and entertainment business, I think, is strengthened. It's not at pre-COVID levels, but it is, I would say, within 10% or 15% of pre-COVID levels. So I think that has recovered relatively well. I think we've gotten stronger at selling StorNext into other verticals, healthcare, surveillance, life sciences. And so, I also think we have a series of new products. We launched StorNext 7 running on Amazon Cloud and AWS.

We also did major upgrades to the H2000, H4000 and now we've launched the H4000 Essentials, which is StorNext combined with CatDV in a single appliance. So I'm seeing the sales momentum pick up in those products. We do have supply constraint. We didn't use to. But now we're just getting much longer lead times sometimes as much as 5 months for just a server, waiting on network cards, power supplies, things of that kind.

One of the issues is when you ship to the U.S. government, you need to ship a server that has its whole chain of custody understood. And to get those systems quoted, ordered and shipped, that cycle time has now gone in the 5 and 6-month level. So what's happening in the government is even though we're getting strong orders, chain of custody based systems where they're entirely ensured that they were either entirely made in the United States or no one ever touched them while they are outside the United States, the supply chain turnaround on that is much longer. So we are seeing supply chain headwinds there, but very strong order strength in the business.

George Michael Iwanyc - *Oppenheimer & Co. Inc., Research Division - Associate*

And with the Pivot3 assets and what you're doing on the video surveillance side, can you give us an update there? How is the customer engagement going? What are you seeing from a cross-sell perspective?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes, I'm really encouraged I mean, I said in my comments, we closed a $4 million surveillance deal with the government entity. We just didn't have the technology to do things like that prior to Pivot3. The Pivot3 business is running ahead of the plan. We put together a 3-year pro forma prior to acquiring the business. And we are exceeding that from a bookings perspective, obviously struggling to fulfill all those orders. Servers used to -- we would order them and we get them 2 to 3 weeks later. We're just not in that kind of period any longer. But the Pivot3 business from a bookings perspective is ahead of plan. And so I feel really good about that business. And like our other businesses, we're just chasing materials and have to ship products.

George Michael Iwanyc - *Oppenheimer & Co. Inc., Research Division - Associate*

All right and Mike, just one question for you. With the $1 million to $2 million savings that you're expecting this quarter, is that all going to be encompassed in this quarter or do you expect to continue to make cuts for maybe a quarter or 2?

James Michael Dodson - *Quantum Corporation - CFO*

Yes, I mean we will continue to always optimize and reduce our expenses, especially when we're under the pressure of the supply constraints. So yes, we would expect that would continue.

Operator

Our next question is from Eric Martinuzzi of Lake Street Capital Markets.

Eric Martinuzzi - *Lake Street Capital Markets, LLC, Research Division - Head of Research & Senior Research Analyst*

Yes, I wanted to go a layer deeper on the cuts. You talk in the press release about cost reduction measures across product categories. Is this potentially -- is this eliminating certain products that may be haven't been this productive because the demand hasn't been there? Or is this really kind of -- it's pretty much people and we're doing kind of across the Board CapEx, OpEx reductions. What's the focus of the reductions?

James Michael Dodson - *Quantum Corporation - CFO*

Yes, well first, there is the -- across all product lines, that's a price increase, right. So we're looking at price increases across all products. We had announced 5% last quarter, and we're putting into place a richer program that I think on average are probably net out about 10 additional points. So that's to help on the gross margins with the higher costs we're seeing there.

The cost reduction programs, it's part of it is doing things like shutdowns, right. And then it's looking at your typical items that you look at, the temporary employees, the contractors. You look at all your discretionary spending, you look at all of your contracts and where can you renegotiate or postpone or push-out. So it's all those types of areas. I mean, we continuously look at how to optimize our expense base.

For example, we just -- at the end of January, completed our move out of the Bellevue facility, for example, which was our largest facility, most expensive lease, right. So we'll get benefits for that going forward as well as we haven't signed up for a new lease there, but it will be much, much smaller lease in that facility.

So it's all of these areas that we continuously look at to optimize our spend, to reduce our costs. The other thing that we do across the Board is try to leverage lower-cost geographies, right. And we've been successful at moving some back office areas to offshore locations, which is also -- that's always an ongoing activity that we have in that area.

Eric Martinuzzi - *Lake Street Capital Markets, LLC, Research Division - Head of Research & Senior Research Analyst*

And this $1 million to $2 million savings in Q4. If I'm starting from a Q3 OpEx of $36.4 million and that includes EnCloudEn, and that includes Pivot3. Is that then to say that this $36.4 million maybe gets reduced by $1.5 million and so $35 million is the new run rate and that we get that kind of $4 million to $8 million of annualized savings. Is that the right way to think of that?

James Michael Dodson - *Quantum Corporation - CFO*

Yes, I mean some of the cost savings we're doing unless you repeat them, such as a shutdown, right you need to do other measures. And we've got other measures in place as well. But yes, I mean you're thinking of it correctly.

Eric Martinuzzi - *Lake Street Capital Markets, LLC, Research Division - Head of Research & Senior Research Analyst*

Okay. And then my last question on the supply chain issues. I know we don't have a real large sample set here. But from my experience, the de-commits can be driven by a couple of things. One can be your supplier is shopping that supply to get a better price, and you weren't able to meet the better price or it can be, they just didn't have it even though they had "committed to you". So I'm just wondering if behavior on de-commits has changed in 2022 versus calendar 2021?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes, I think it has. We have some products that we have received consistently for 20-plus years. And our suppliers have just come forward and said, we're not going to make it anymore. We have other products we're going to make that are more profitable. They just stopped making a part that we have orders going out in some cases well over a year. We have some sub $2 and $3 components. Think of them as like a socket connector, where the supplier came back and said, we'd like $150 now for that part.

We have some orders that we made over a year ago, so plenty of lead time where our partner came back and said, we have none of that part for you, and we cannot tell you when you will get -- we have another major partner just said we're giving you 6-weeks' notice that we're increasing prices 25%. We did not see that in previous quarters and previous times that these are -- they are more of these occurring. They're occurring more quickly, and that's why we're moving very swiftly on pricing increases. We're also taking those very troubling components, and we are ripping them out of our products. We can't be in a position where we're held for ransom quarter-after-quarter.

So we're actually taking those very troubling components rather than negotiating for them because we're never going to have the negotiating power of a Cisco or a Ford Motor Company. We're actually taking the component out of the product, redesigning it with another component that is much easier to procure.

Eric Martinuzzi - *Lake Street Capital Markets, LLC, Research Division - Head of Research & Senior Research Analyst*

Okay. And I said that was my last one, but I do have one more a risk of substitution for Quantum product, specifically in the hyperscalers. I'm thinking they kind of designed for Quantum. So this is very low risk, but any behavior there that would indicate otherwise?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes, I mean it is a theoretical possibility. I want to recognize that. I have not seen any order switching, order cancellation because most of the components that are in short supply are made by a single supplier. So no other supplier is advantaged. So I have not seen people flip flopping orders to other suppliers so far.

Operator

(Operator Instructions) Our next question is from Craig Ellis of B. Riley.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

Thanks for taking the follow-up. Mike, I wanted to just touch on the trends in the service revenue line. So we had a nice gradual climb as we were going from late fiscal '21 through the fiscal second quarter of '22. And in December, we pulled back a little bit. Can you just talk about some of the puts and takes that we saw in services in the quarter? And do you expect that we'll get back on that growth slide plan or where do we go from here in services?

James Michael Dodson - *Quantum Corporation - CFO*

Yes, I mean, similar to signing up new contracts it is -- there is a bit of seasonality there that if they don't sign, we can't recognize the revenue. So historically, you've got a little bit of seasonality in there. And we always have underneath the golden glide that is always trying to pull that down, right. And then we're signing up new services and growing in other areas, right. So it's kind of -- it's an offset in that and just a touch of seasonality.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

And is there any impact from supply chain there is any parts or components, spares, et cetera, in that line is that all true services?

James Michael Dodson - *Quantum Corporation - CFO*

Yes, it's not -- it doesn't have a material impact. It did cost-wise, where we saw some of our costs because the margins came down, but not really a top line.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

And so just on that margin point, I think 57% in the quarter, a year ago we were at 60%. What's your expectation for the margin trajectory in services from here?

James Michael Dodson - *Quantum Corporation - CFO*

Yes, I mean we're -- we've got also some programs to reduce costs on the gross margin line, but those are tougher and some of those are longer range to put into place. So it's going to be really pricing driven. And we are looking at increasing our prices on services as well. And really, that's more along the lines of discounting less is what we're putting into place. So we'll do what we can and get what traction we can to get those margins back up to 60%.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

And how would you break out the drivers to the decrease from 60% to 57%?

James Michael Dodson - *Quantum Corporation - CFO*

It was -- we have for example, a repair organization. So repair costs increased, warehousing costs increased, all the logistics of our spares organization increased. So those are some of the key areas that we saw the costs go up.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

Got it. And it's just better execution on those variables to drive it back to 50?

James Michael Dodson - *Quantum Corporation - CFO*

Yes.

Operator

We have reached the end of the question-and-answer session. I will now turn the call back over to Jamie Lerner for closing remarks.

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Thank you. While our bookings were at the highest level they've been at in years, we have to recognize that the global supply situation put us in a position where the results have fallen beneath all of our expectations. But I'm confident in the underlying strength of this business. Our bookings levels, our hyperscaler wins, the strides we're making in video surveillance, tell me that we have a growing business.

Now I'm also realistic. We've got to make some very, very quick cost cutting and sizable cost cutting. We've got to get our pricing in line with what our suppliers are doing with many of our components going up as much as 25%. And we've got to work very hard with our suppliers to make sure we get our fair share of componentry.

But I think we can take those measures. We can do them quickly and see this to the other side of the supply chain. And when we do, I think Quantum is going to be a larger company, a better company and a bigger company, but we've got a few tough quarters to get through, and we're taking the measures to see that the company can do that in a healthy way.

With that, thanks everyone, for attending today.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation, and have a great day.